

P-421/EI-89-860 ORDER REQUIRING FURTHER FILINGS

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

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Chair
Commissioner
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Commissioner

In the Matter of U S WEST
Communications, Inc.'s Incentive
Regulation Plan

ISSUE DATE: October 6, 1993

DOCKET NO. P-421/EI-89-860

ORDER REQUIRING FURTHER FILINGS

PROCEDURAL HISTORY

I. History of this Proceeding

On October 30, 1989, U S WEST Communications, Inc. (U S WEST or the Company) filed a proposed incentive plan under Minn. Stat. § 237.625 (1992). Under incentive regulation a company is allowed to earn amounts in excess of its authorized rate of return, and is required to share a specified percentage of such amounts with its ratepayers. The percentage of excess earnings to be shared is set by the Commission to reflect the relative risks the plan imposes on ratepayers and shareholders.

On June 7, 1990 and September 17, 1990 the Commission issued Orders in this docket accepting the proposed plan subject to specified modifications. On October 5, 1990, the Company accepted the incentive plan as modified by the Commission. The plan was later modified, by agreement with the Company, to exclude the financial effects of FCC-deregulated services from earnings and sharing calculations. ORDER AMENDING INCENTIVE PLAN AND ACCEPTING INCENTIVE PLAN FILINGS (May 20, 1991).

II. The Filings at Issue

The Orders modifying and adopting the proposed incentive plan required the Company to file detailed financial reports annually, setting forth calendar year earnings, proposed sharing amounts, and supporting work papers. The Orders also required regular reports on Company compliance with other incentive plan requirements: (1) annual reports on Company progress in updating connection facilities with independent local exchange carriers; (2) annual reports on Company progress in implementing its rural modernization program; (3) quarterly reports on quality of service, measured by five objective criteria as well as the results of customer satisfaction surveys.

On January 29, 1993 the Company filed its annual reports on the rural modernization program and on updating its connection facilities with independent local exchange carriers. The Company filed quarterly quality of service reports on schedule throughout the year.

On March 31, 1993 the Company filed its 1992 financial reports. On April 30, 1993 the Company filed its Notice to the Commission -- Incentive Plan Sharing Summary. Those filings reported \$3,414,000 in earnings over the plan's sharing threshold.

Under the terms of the plan, earnings over the sharing threshold were to be divided evenly between ratepayers and shareholders. After applying the plan's revenue conversion factor, which adjusts for taxes, to the ratepayers' share, the Company proposed to distribute \$2,886,000 to ratepayers. This amount was later changed to \$3,516,000 to correct an error in calculating nonregulated rent compensation. The Company had made the same error in calculating earnings subject to sharing in 1990 and 1991, and the adjustment included 1990 and 1991 sharing corrections.

The Department of Public Service (the Department) and the Residential Utilities Division of the Office of the Attorney General (RUD-OAG) filed comments on the Company's filings. The Department raised four challenges to the Company's sharing proposal: (1) the Department challenged the interarea rents allocated to Minnesota customers on computers; (2) the Department challenged the interarea rents allocated to Minnesota customers on two buildings, one in Colorado and one in Arizona; (3) the Department questioned the Company's decision to expense rather than amortize specific computer software costs; (4) the Department recommended amortizing, instead of expensing, approximately \$32 million to be spent from 1992 to 1994 to implement a 1991 decision to eliminate 6,000 positions from the work force.

The RUD-OAG challenged the reduction in earnings resulting from the accounting change required under Financial Accounting Standard 106. Subsequent to the filing of comments, that issue was decided in a separate docket, In the Matter of U S WEST Communications, Inc.'s Petition to Recover the Costs of Implementing Accounting Changes Required under Financial Accounting Standard 106, Docket No. P-421/M-93-126, ORDER AUTHORIZING RECOVERY OF COSTS OF IMPLEMENTING FINANCIAL STANDARD 106 (July 21, 1993). The RUD-OAG also raised concerns about service quality.

The filings came before the Commission on September 28, 1993.

FINDINGS AND CONCLUSIONS

III. Commission Action

The Commission has examined the Company's filings and the parties' comments and concludes it needs more information to make a determination on the reasonableness of the Company's sharing proposal. The Commission will defer action on the proposal until the Company has filed the additional information outlined below and interested parties have had opportunity to comment.

A. Information on Downsizing the Work Force

In 1991 the Company made a decision to downsize its work force by 6,000 positions over a three year period. In 1992 it spent some \$10.9 million implementing that decision; it deducted that amount from 1992 earnings in calculating earnings subject to sharing.

The Company states the downsizing was necessary to respond to changes in the telecommunications industry resulting from divestiture, competition, and technological advances. The Commission appreciates the fact that change has become an enduring feature of the telecommunications industry. This has been true for over a decade, however. The Commission needs reassurance that this abrupt need to reduce the work force, with all the expense and disruption it entails, could not have been prevented by careful and continuous monitoring of total labor productivity over the preceding years. The Commission will therefore require the Company to provide the information and materials outlined below.

(1) Please state the amount of expense incurred in 1992 to implement the 1991 work force reduction decision. Please state the total amount of expense the Company projects will be necessary to implement the work force reduction decision.

(2) Please state what portion of these expenses are "normal" employee termination expenses, i.e., expenses that would have been incurred had the employees terminated employment in normal course under company policies in effect before the 1991 work force reduction decision. Please itemize these expenses.

(3) Please state what portion of these expenses are inducements or incentives to employees to choose termination over continued employment, e.g., pension enhancements or extended health care coverage. Please itemize these expenses.

(4) Please state what portion, if any, of these expenses represent termination benefits added to the standard benefits package to meet the special needs created by major work force reductions, e.g., enhanced outplacement services, longer severance pay periods, counseling services, etc. Please itemize these expenses.

(5) Please describe in detail the tools management used during the five years preceding the work force reduction decision to manage the work force and track total labor productivity. Please describe how management measured total labor productivity, how frequently it was measured, to whom reports on total labor productivity were submitted, and how frequently these reports were submitted. Please state the substance of these reports.

(6) Please list all reports and other documents on which management relied in recommending to the Board of Directors the 1991 work force reduction decision.

(7) Please describe the process by which management concluded that 6,000 positions must be eliminated from the work force. Please state when internal discussions began, how the issue was analyzed and investigated, and when it was first discussed at the Board level.

(8) Please list all reports and other documents on which the Board of Directors relied in making the 1991 work force reduction decision.

(9) Please file copies of all Board minutes pertaining to Board discussions leading up to and dealing with the work force reduction decision made in 1991.

(10) Please give the Company's best estimates on when the work force first became too large, its best estimate on how many excess positions it included at that time, and as detailed an account as possible of how and when the number of excess positions grew to 6,000.

B. Information on Accounting Treatment of Computer Software

Company account number 6724.9 included some \$23.5 million in expenses associated with the development and maintenance of computer software. The Department challenged the expensing of this account, saying it included expenditures for the purchase of software with a useful life exceeding one year. Assets with useful lives of over one year are generally amortized rather than expensed.

The account included costs for travel, meals, training, research, and other items whose relationship to software maintenance was

unclear. The Commission will require the Company to provide the following information to clarify the status of this account.

(1) Please provide a more detailed itemization of the costs included in account 6724.9. Listings such as "travel" and "meals" should specify the purpose of the travel and the job title of the traveler. Similarly, "research" listings should describe the research conducted and its ultimate application, if any.

(2) Please state the total amount of software purchase costs included in the account. To the maximum extent possible, state the normal useful life of the software purchased and the facts upon which the useful life estimate is based.

(3) Please state the total amount of software development costs included in the account. To the maximum extent possible, state the normal useful life of the software developed and the facts upon which the useful life estimate is based.

C. Information on Quality of Service

Maintaining or improving quality of service is an important goal of incentive regulation. The statute authorizing the Company's incentive plan provides as follows:

The purpose of the plan is to provide an incentive to the company to improve its operating efficiency while maintaining or improving the quality of its service.

Minn. Stat. § 237.625, subd. 1 (1992).

Because of the statutory emphasis on quality of service, the Commission's Orders authorizing the Company's plan required quarterly reports on quality of service, measured by five objective criteria as well as customer surveys.

The RUD-OAG expressed concern that the Company's quality of service may have deteriorated over the life of the plan. The Commission has already initiated an investigation into one area of concern identified by the RUD-OAG, delays in new service installations. In the Matter of a Commission Initiated Investigation into U S West Communications, Inc.'s Service Installation Intervals, Docket No. P-421/CI-92-1381.

The Commission will require the Company to provide the following information to help clarify quality of service issues.

(1) Please supplement trouble reports filed since March 1992 to include all exchanges serving any Minnesota customer. Please provide trouble reports for each wire center within each exchange. Please include this level of detail in future trouble reports.

(2) Please explain the role service quality issues played in the 1991 work force reduction decision.

(3) Please describe in detail Company plans for monitoring the effect of work force reductions on quality of service.

(4) Please list all reports and other documents on which management relied in recommending to the Board of Directors the 1991 work force reduction decision which deal with how quality of service and work force reductions affect one another.

(5) Please list all reports and other documents on which the Board of Directors relied in making the 1991 work force reduction decision which deal with how quality of service and work force reductions affect one another.

D. Time Frames

The Company's plan provides that shared earnings will normally be distributed to ratepayers during the July billing cycle. This schedule was changed by mutual consent for 1992 earnings to allow adequate time to determine the effect of new Financial Accounting Standard 106. That determination was made on July 21, 1993 as noted above. The Commission is committed to resolving the remaining issues promptly. Parties should make every effort to comply with the expedited time frames set forth below. Parties who find it impossible to comply may request time extensions.

ORDER

1. Within 20 days of the date of this Order, the Company shall file the information required thereunder.
2. Within 15 days of the Company's filing, interested parties shall file reply comments.
3. Within 10 days of the expiration of the reply comment period, the Company shall file any final comments.
4. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Susan Mackenzie
Acting Executive Secretary

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